

Scenario 6

Market Assessment and Supply Procurement Review

***Procurement Working Group
Meeting***

July 6, 2004

Scenario 6: Resource Planning Alternative

Scenario 6 Objective

- *Develop conceptual framework for post 2006 resource planning alternative*
- *Consistent with traditional utility resource planning principles and processes*
- *Adapted to reflect contemporary competitive market structure*
- *Reliable, competitively priced retail service under a range of market conditions*

Traditional Utility Resource Planning

- *Periodic regulatory review; filing and supply procurement requirements*
- *Utility provided assessment of system requirements*
 - *Comprehensive and detailed load forecast*
 - *Assessment of supply requirements; resource mix and optimization*
- *Participation by interested parties*
- *Commission approved settlement/hearings; commission findings and orders*
- *Utility supply procurement consistent with commission approved plan*

Market Assessment and Supply Procurement Review

Formal process and forum for review pursuant to statutory requirements

- *Assessment of market conditions and rationale for proposed procurement program*
- *Forum for interested party participation*

Not traditional utility resource planning

- *No lengthy, detailed supply/demand forecasts*
- *No administratively determined process for procuring supply*

Not a burdensome, inefficient administrative process for utilities or the Commission

- *Replaces inefficient, ad hoc process to address unanticipated market developments*
- *Efficiency will improve with experience*

Framework that supports market based, competitive supply procurement

- *Does not prescribe a particular procurement solution*
- *Flexibility to adapt procurement strategy to changing market conditions*
- *Opportunity to consider actions that mitigate future risk*
- *Specific consideration of utility affiliate supply arrangements*

Accommodates a wide range of competitively procured supply alternatives

- *Auctions, RFPs, bi-lateral negotiations*
- *Long/short term, requirements service, portfolio management*

Key Elements of MASP Review

Wholesale market assessment

- *Fundamental analysis: regional RTO supply/demand sufficiency; price trends*
- *RTO market structure: capacity/energy products; seams issues; market power*
- *Participants: utility, merchant generator, marketer/trader; financial strength*

Retail market assessment

- *Fundamental analysis: competitive supplier v. customer product demand; price trends*
- *Market structure: unbundled tariff services*
- *Participants: utility POLR, ARES ; financial strength*

Supply Procurement

- *Identify requirements: POLR service v. ARES provided*
- *Identify strategy: supply procurement consistent with market conditions and outlook*
- *Identify risk/reward: trade-offs associated with supply plan; risk/reward profile*

Cost Recovery and Rate Design

- *Mechanism for recovering supply costs*
- *Rate design issues*

MASP Review Statutory Requirements

Legislation would be required to implement MASP Review

- *Mandated process for supply planning and procurement*
- *Utility and ICC statutory obligations*

Utility obligations

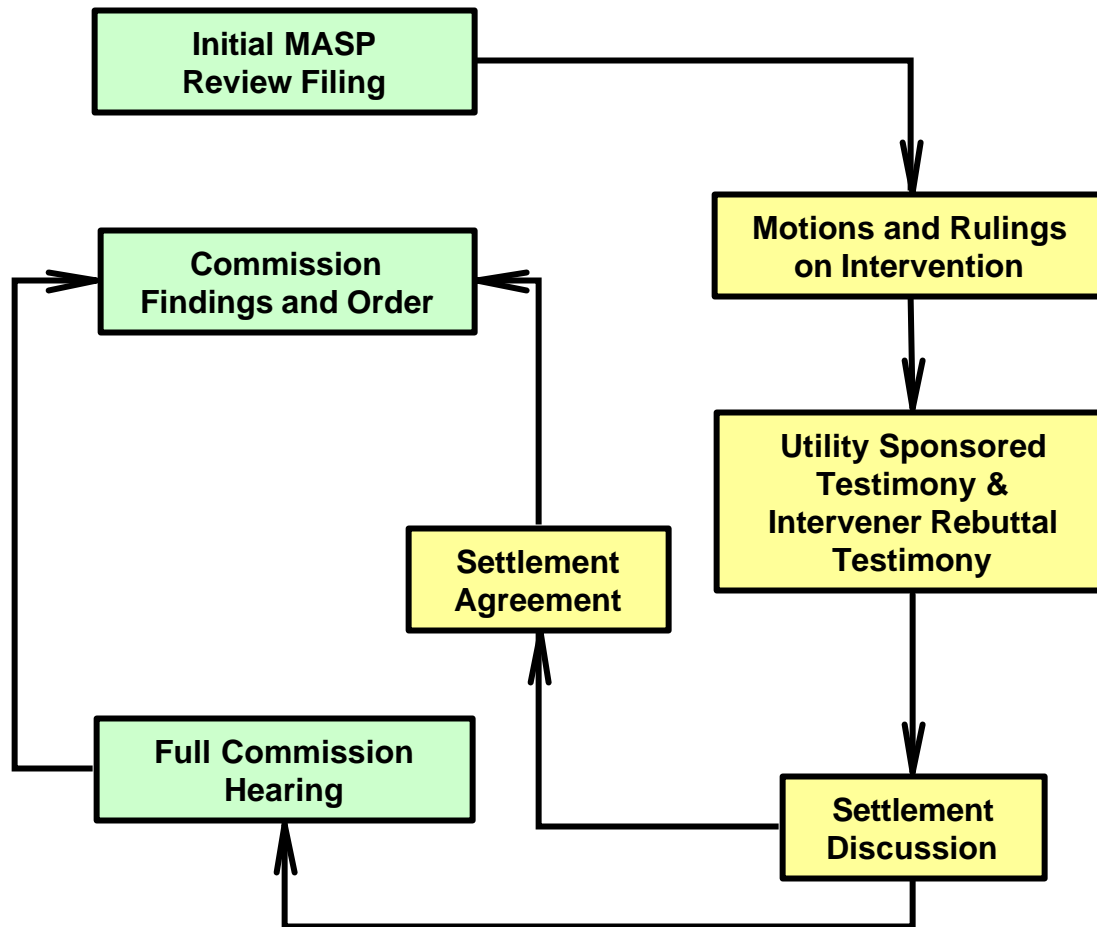
- *Utility's obligation to plan and procure required supply*
- *Filing requirements including timing and frequency*
- *Filing content*

Commission obligations

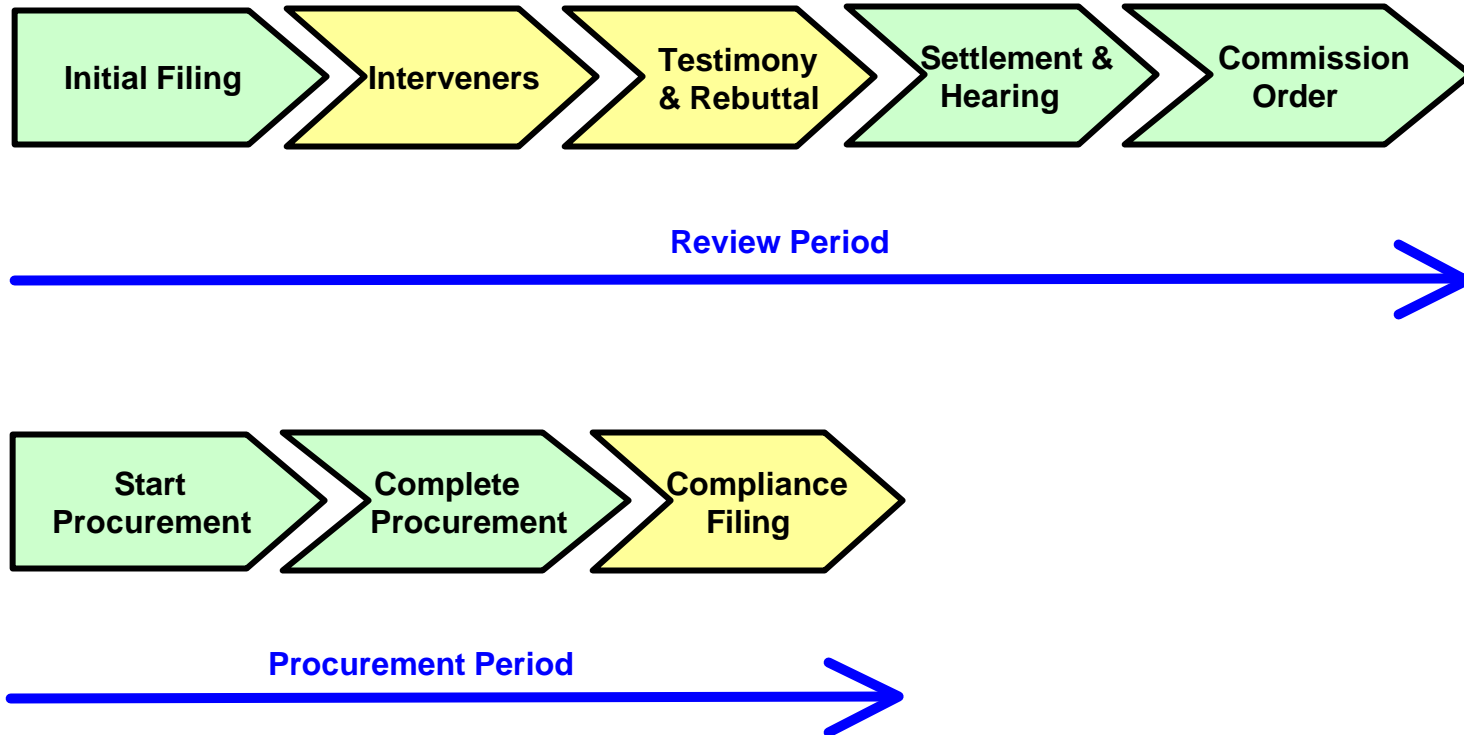
- *Commission authorities*
- *Standards for review*
- *Prudence*
- *Cost recovery and rate making*

MASP Review Process

Supply Procurement Review and Approval Process



MASP Review Timeline



MASP Review Pros

Flexible, transparent process providing comprehensive regulatory review of markets and utility procurement programs

Preserves legacy expertise of utilities to plan and arrange for supply requirements of bundled service customers

Provides a mechanism to address near- and long-term resource adequacy

Provides flexibility for each utility to tailor a procurement program that addresses their specific requirements

Provides a presumption in favor of competitive procurement while preserving the option of using other procurement methods

Flexibility to adjust procurement strategies to changes in market conditions and RTO market structure.

Does not prejudice, preclude or include any specific procurement program

Provides a forum for market participants

Provides prudence review and approval prior to a utility's commitment to specific resources

Provides a mechanism to recover costs associated with approved supply procurements

MASP Review Cons

Specific and detailed legislative requirements

Utility staff resources dedicated to ensuring compliance, developing filings and supporting proceedings

Commission staff resources dedicated to reviewing compliance with statutory requirements and managing multiple utility planning cycles

Judgment based review; no easily quantifiable metrics for decision making

Litigation in proceedings where parties cannot establish agreement

Example MASP Reviews

Hypothetical Market Conditions

Case 1: Stable Wholesale and Emerging Retail

Case 2: Stable Wholesale and Robust Retail

Case 3: Volatile Wholesale and Developing Retail

Case 1: Stable Wholesale/Emerging Retail

Wholesale market assessment

- *Fundamental analysis*
 - *Surplus regional supply; stable price outlook*
- *RTO market structure*
 - *Typical seasonal congestion; no significant seams or other structural issues*
 - *Limited instances of RTO imposed price mitigation*
- *Participants*
 - *Regional utility affiliate merchants adding incremental capacity to existing stations*
 - *Stable IPP sector; improving credit quality*
 - *Increasing participation by financial services firm*

Retail market assessment

- *Fundamental analysis*
 - *Selective participation by competitive suppliers; price trends reflect wholesale market conditions*
 - *Attractively priced utility provided POLR service*
- *Market structure*
 - *Efficient open access tariff*
 - *No transition or other administrative charges*
- *Participants*
 - *Utility POLR service*
 - *Reasonably strong ARES credit quality*

Case 1 (con't)

Supply Procurement

- *Requirements*
 - *Limited ARES provided service*
 - *Substantial portion of retail customer base on expiring POLR service*
- *Strategy*
 - *Continue POLR Service for a 3 yr period*
 - *Fixed price full requirements service*
 - *Purchase annual requirements through annual auction process*
- *Identify risk/reward*
 - *Benefit from current stable price environment*
 - *Higher probability that price volatility will remain low through procurement period*
 - *Adjust plan; purchase year 2 and 3 in second year if price outlook becomes volatile*

Cost Recovery and Rate Design

- *Purchased power adjustment charge*
- *Flat annual rates*

Case 2: Stable Wholesale/Robust Retail

Wholesale market assessment

- *Fundamental analysis*
 - *Surplus regional supply; stable price outlook*
- *RTO market structure*
 - *Typical seasonal congestion; no significant seams or other structural issues*
 - *Limited instances of RTO imposed price mitigation*
- *Participants*
 - *Regional utility affiliate merchants adding incremental capacity to existing stations*
 - *Stable IPP sector; improving credit quality*
 - *Increasing participation by financial services firm*

Retail market assessment

- *Fundamental analysis*
 - *Strong and increasing participation by competitive suppliers; price trends reflect wholesale market conditions*
 - *Utility provided POLR service*
- *Market structure*
 - *Efficient open access tariff*
 - *No transition or other administrative charges*
- *Participants*
 - *Less than 10% of customers taking utility provided POLR service*
 - *Reasonably strong ARES credit quality*

Case 2 (con't)

Supply Procurement

- *Requirements*
 - *Most customers are taking ARES provided service*
 - *Those not on ARES service have ample opportunity to take service from multiple suppliers providing a range of products*
- *Strategy*
 - *Continue POLR Service*
 - *Full requirements service at RTO market clearing prices*
 - *No formal procurement processes required*
 - *POLR requirements settled with RTO*
- *Identify risk/reward*
 - *Risk of increasing POLR exposes only a small fraction of customers who have alternatives*
 - *Ample opportunity to take fixed price service from one of many suppliers*
 - *No future obligations which will ultimately be borne by customers*

Cost Recovery and Rate Design

- *Purchased power adjustment charge*
- *Seasonally shaped rates*

Case 3: Volatile Wholesale/Developing Retail

Wholesale market assessment

- *Fundamental analysis*
 - *Regional reserve margins under pressure; volatile price outlook*
- *RTO market structure*
 - *Congestion patterns reflect zonal supply/demand balance*
 - *Numerous instances of RTO imposed price mitigation*
- *Participants*
 - *Regional utility affiliate merchants have not been adding incremental capacity in the most effective locations*
 - *Challenge for IPP sector to finance merchant facilities; investor reluctance to spec investment in RTO markets*
 - *Robust participation by financial services firm*

Retail market assessment

- *Fundamental analysis*
 - *Moderate participation by competitive suppliers; customers reluctant to take annual service at high prices*
 - *Utility provided POLR service at RTO clearing price*
- *Market structure*
 - *Efficient open access tariff*
 - *No transition or other administrative charges*
- *Participants*
 - *ARES under pressure with limited customer demand for relatively high fixed price service*

Case 3 (con't)

Supply Procurement

- *Requirements*
 - *Limited ARES provided service*
 - *Substantial portion of retail customers taking utility provided POLR service at RTO market clearing prices*
- *Strategy*
 - *Utility provided POLR service*
 - *Utility managed full requirements service at cost*
 - *Mitigate price volatility through mix of supply products and terms*
 - *Combination of spot, short and longer term commitments*
 - *No more than Y% of requirement purchased for more than a Z yr period*
- *Identify risk/reward*
 - *Manage exposure to volatility by committing a measured portion of portfolio to long term supply*
 - *Higher probability price volatility will remain high in the medium term*
 - *Adjust procurements over X yr period to balance price and risk associated with long term commitments*

Cost Recovery and Rate Design

- *Purchased power adjustment charge*
- *Enduring charges to recover cost associated with long term commitments*